

**BEFORE**  
**THE PUBLIC SERVICE COMMISSION OF**  
**SOUTH CAROLINA**  
**DOCKET NO. 2007-286 -WS**

**RECEIVED**  
**2007 NOV 14 PM 4:45**  
**SC PUBLIC SERVICE**  
**COMMISSION**

IN RE:

Application of Utilities Services of  
South Carolina, Inc. for adjustment of  
rates and charges and modifications to  
certain terms and conditions for the  
provision of water and sewer service.

**DIRECT TESTIMONY**  
**OF**  
**B.R. SKELTON, Ph.D.**

**Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.**

A. My name is B. R. Skelton and my business address is 2962 Walhalla Highway,  
Six Mile, South Carolina 29682. I am Professor *Emeritus* of Economics at Clemson  
University and am engaged in a variety of private business endeavors, including real  
estate brokerage and residential construction. I also act as a mediator and arbitrator.  
Since 1974, I have mediated 190+ disputes and written decisions in over 1000 arbitration  
cases, mostly union-management grievances. I have also arbitrated deferrals from the  
courts and the NLRB.

**Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND  
PROFESSIONAL EXPERIENCE.**

A. I received my B.S. degree in Arts & Sciences (History & Economics) from  
Clemson University in 1956. In 1958, I received a Masters of Science degree in  
Agricultural Economics from Clemson University. I received my Ph.D. in Economics  
from Duke University in 1964.

1           From 1959 to 1987, I was a professor of Economics at Clemson except for 1961-  
2           63 when I was in graduate school at Duke University. In addition to teaching standard  
3           economic theory, my academic background includes writing, lecturing and research in  
4           the areas of labor economics, economic development and arbitration. While at Clemson,  
5           I was a member of the Southern Economics Association and American Economic  
6           Association. I was also a member of the Arbitration Panel of the Federal Mediation and  
7           Conciliation Service and the American Arbitration Association. I retired from Clemson  
8           in 1987.

9   **Q.   PLEASE DESCRIBE YOUR WORK IN THE REAL ESTATE FIELD.**

10  A.           Over time I have developed subdivisions, commercial property, apartments and  
11           bought and sold real estate of all types.

12  **Q.   DO YOU PROVIDE ANY CONSULTING SERVICES?**

13  A.           I have served as a consultant to various individuals and companies, mostly  
14           wrongful death and injury, divorce, product liability and valuation of business losses. I  
15           was President of Economic Research and Consulting Associates prior to 1980, the  
16           business that provided this analysis. I have testified before the PSC in one case involving  
17           a water company in Oconee County and in three cases involving affiliates of Utilities  
18           Services of South Carolina (“USSC” or the “Company”) – Carolina Water Service, Inc.,  
19           Tega Cay Water Service, Inc. and United Utility Companies, Inc.

20  **Q.   DO YOU HOLD ANY OTHER PROFESSIONAL DESIGNATIONS?**

21  A.           Yes. I am a mediator and arbitrator and am licensed by the State of South  
22           Carolina as both a real estate broker and residential contractor. I am also an elected  
23           member of the National Academy of Arbitrators and have been a member since 1981.

1 **Q. DR. SKELTON, PLEASE DISCUSS THE BASIS FOR YOUR OPINIONS IN THIS**  
2 **CASE.**

3 A. I am qualified to offer my opinions in this case based on my studies, research,  
4 teaching, writing and consulting in the field of economics and on my experience as a real  
5 estate investor and broker and as a business person.

6 My opinions are based on my analyses of the relevant materials I have reviewed  
7 to date, opinions of current and former academic colleagues in the field of economics,  
8 and my fifty years of teaching, writing, researching, consulting, and lecturing in the field  
9 of economics. I may supplement, refine, or revise my analyses as appropriate based on  
10 additional testimony, documents, or other materials that may become available in this  
11 case.

12 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

13 A. The purpose of my testimony is to express opinions regarding the impact that  
14 general economic conditions during the course of the last two years should reasonably be  
15 expected to have on the allowable return on equity granted by this Commission to USSC  
16 in its last rate case. In addition, I will opine as to the range of returns on equity supported  
17 by the testimony of USSC witness Pauline Ahern.

18 **Q. WHAT KEY DOCUMENTS AND OTHER MATERIALS DID YOU CONSIDER**  
19 **IN REACHING YOUR OPINIONS?**

20 A. The key materials used by me in my analysis are as follows:

- 21 • Commission Order Number 2006-22 in Docket Number 2005-217-W/S.
- 22 • 10 year bond yields, federal funds rate, prime rate, C.D. rate, Libor rate,
- 23 trends in economic activity and employment data.

- Prepared Direct Testimony of Pauline M. Ahern, Principal of AUS Consultants – Utility Services, filed on behalf of USSC.

**Q. DR. SKELTON, WHY HAVE YOU REVIEWED THE COMMISSION ORDER IN THE COMPANY'S LAST RATE CASE?**

A. I reviewed the Company's most recent rate case order so that I could to determine what return on equity the Commission considered and approved in adopting the Settlement Agreement between the Company and the Office of Regulatory Staff ("ORS").

**Q. WHAT DID YOUR REVIEW OF THAT ORDER REVEAL IN THAT REGARD?**

A. In the Company's last rate case, the Commission approved a return on equity of 9.75%.

**Q. DOES THE RETURN ON EQUITY SET IN THE COMPANY'S LAST RATE CASE BEAR ON YOUR OPINION IN THIS CASE?**

A. Yes, but the number is only incidental to my opinion.

**Q. WOULD YOU ELABORATE ON THAT LAST STATEMENT?**

A. Yes. Regardless of whether one agrees with the return on equity set in the Company's last rate case, it does establish a benchmark that is relevant to this case. This is so because, if one assumes that the return on equity of 9.75% set less than two years ago was reasonable, then one can apply basic economic theory to approximate what a reasonably corresponding return on equity would be today using that benchmark. Of course, depending upon the generally prevailing economic circumstances during the interim period, that approximation of a reasonably corresponding return on equity today could be higher or lower than the benchmark return that is used.

1 **Q. WHAT IS THE BASIC ECONOMIC THEORY TO WHICH YOU ARE**  
2 **REFERRING?**

3 A. During the past two years the Federal funds rate, bond yields, prime rate and C.D.  
4 rate have all increased. No prudent and reasonable investor would be willing to invest  
5 today unless they could expect to earn a higher return than when the above rates were  
6 lower, as they were two years ago. Moreover, as rates on competing investments  
7 increase, bond rates and interest costs are likely to increase for companies competing for  
8 additional funds.

9 **Q. DR. SKELTON, WOULD YOU PLEASE DESCRIBE THE GENERAL**  
10 **ECONOMIC CONDITIONS WHICH HAVE PREVAILED IN THE UNITED**  
11 **STATES OVER THE LAST TWO YEARS?**

12 A. Yes. In general, the country has experienced the potential and actual inflationary  
13 pressures, reflected in the increases in the Federal Funds Rate and corresponding interest  
14 rates. The stock market has shown profitability and stock price increases making that  
15 market more competitive for the funds of investors.

16 **Q. DR. SKELTON, IN LIGHT OF THE GENERAL ECONOMIC CONDITIONS**  
17 **FOR THE PAST TWO YEARS THAT YOU HAVE JUST DESCRIBED, WOULD**  
18 **A REASONABLE RETURN ON EQUITY BE HIGHER OR LOWER THAN**  
19 **THAT SET IN THE COMPANY'S LAST RATE CASE?**

20 A. In my opinion, it would have to be higher when basic economic principles are  
21 applied. The answers to the two previous questions provide the rationale for this opinion.

1    **Q     DR. SKELTON, ARE YOU FAMILIAR WITH THE BASIC STANDARDS THAT**  
2       **APPLY IN SETTING THE ALLOWED RATES OF RETURN FOR PUBLIC**  
3       **UTILITIES?**

4    A.       Yes, I have a general understanding that the *Bluefield*<sup>1</sup> and *Hope*<sup>2</sup> decisions of the  
5       United States Supreme Court have established that a utility should be allowed an  
6       opportunity to realize earnings at a sufficient level so that it is able to attract capital at  
7       reasonable cost and an opportunity to realize earnings at a level comparable to firms  
8       facing equivalent risk.

9    **Q.   DO YOU ALSO HAVE A GENERAL UNDERSTANDING OF PRINCIPLES OF**  
10       **ECONOMICS WHICH ARE IMPORTANT TO AN ESTIMATE OF THE COST**  
11       **OF EQUITY CAPITAL FOR A UTILITY?**

12   A.       Yes, I do and it would be the same as for any business. In the economics of  
13       finance, I understand that two principles that are generally accepted when estimating the  
14       cost of capital for a firm are (1) that a firm should not undertake new investments in plant  
15       and equipment unless the prospective return on such investments equals or exceeds its  
16       cost of acquiring capital funds and (2) that risk and return are interrelated such that  
17       investors in a firm with higher than average risk must be compensated by the promise of  
18       a higher than average return.

19   **Q.   IN YOUR REVIEW OF MRS. AHERN'S TESTIMONY, DO YOU FIND THAT**  
20       **SHE APPLIES THESE STANDARDS AND PRINCIPLES?**

---

<sup>1</sup> *Bluefield v. Public Service Commission, et.al.*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176, 1923 U.S. LEXIS 2676 (1923).

<sup>2</sup> *Federal Power Commission, et. al. v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333, LEXIS 1204 (1944).

1 A. Yes, I do. Of course, her analysis is extensive and addresses many other issues  
2 which bear on her opinion, but I read her opinion as recognizing the standards and  
3 principles I just discussed.

4 **Q. DO YOU AGREE WITH MRS. AHERN'S OPINION REGARDING AN**  
5 **ESTIMATE OF A REASONABLE RANGE OF RETURNS ON EQUITY FOR**  
6 **THE COMPANY?**

7 A. Yes, I do agree with Mrs. Ahern's recommended range of 11.40% to 12.00%. I  
8 would note that she arrives at this determination as a matter of informed judgment based  
9 upon an extensive analysis which involves the application of several different models to  
10 approximate reasonable returns on equity. As her testimony reflects, these models  
11 individually produce estimated returns of as much as 14.30% and as little as 9.80%.  
12 Given rising interest rates, as evidenced by the 0.14% increase in the average yield on  
13 Moody's "A" rated public utility bonds from March, 2007, to May, 2007, as shown on  
14 page 4 of Exhibit PMA-10 accompanying Mrs. Ahern's testimony, a range of 11.40% to  
15 12.00% seems eminently reasonable.

16 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

17 A. Yes, it does.  
18